

President's Commission on the
United States Postal Service

Statement of

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EXECUTIVE SUMMARY

Valpak is a large Postal Service customer, reliant on the Postal Service to perform ably its core mission and function — mail delivery. Valpak believes that the Postal Service’s fundamental problem to date has been its failure to achieve sustained productivity gains consistent with those of the private sector, as illustrated by Table 1, resulting in too-frequent rate cases and too-high rate increases. The solution lies in controlling and reducing the Postal Service’s costs, not changing the rate-making mechanism administered by the Postal Rate Commission, which actually works quite well. Meaningful increases in Postal Service productivity, achievable through reducing the labor force using existing technology, would lead to fewer rate cases and more reasonable rate increases. Valpak recommends closing/consolidating unnecessary postal facilities — by depoliticizing the issue and following the GAO’s lead.

Valpak believes that the Postal Service’s Universal Service Obligation (“USO”) can be improved by: (i) making retail operations more efficient — including allowing the Service to close redundant facilities; (ii) encouraging the Service to keep up its delivery service, while cutting back on delivery frequency; and (iii) improving its mail collection efficiency, including subcontracting certain collection efforts. The Postal Service should maintain USO standards, but allow them to evolve. Also, by explicitly excluding the Service’s “upstream activities” (*e.g.*, mail processing, transportation) from the USO as well as the postal monopoly, the President’s Commission can help assure that the Postal Service will compete with the private sector more fairly.

In the Postal Service’s evolution toward a competitive government enterprise as suggested by the Postal Service’s Transformation Plan, Valpak suggests that the Commission recommend prohibiting the use of the monopoly to subsidize upstream services and allowing the Postal Rate Commission to interpret the monopoly. This will result in a better Postal Service as well as fairness to private enterprise.

Finally, Valpak believes that the Postal Service’s statutory debt limit should be increased, for investment purposes only, from the longstanding \$15 billion (which, because of inflation, should be \$44 billion in real economic terms) to \$50 billion. It should be clear, however, that such borrowings should be used to modernize the Postal Service infrastructure and effect productivity improvements, and not to underwrite operating deficits. Valpak believes that the Commission’s recommendation for such investment in the Postal Service’s core mission — mail delivery — by modernizing the postal network, rather than competitive non-postal ventures, will help bring about much desired change.

STATEMENT

My name is William Disbrow and I am President and CEO of Cox Target Media, Inc. I appreciate the opportunity to submit these comments to the President's Commission on the United States Postal Service. We hope these comments will be useful and we would be pleased to provide any further information that may be required.

Valpak Direct Marketing Systems, Inc.

Valpak Direct Marketing Systems, Inc., a wholly-owned subsidiary of Cox Target Media, Inc., is the nation's largest firm in the subset of the hard-copy, direct mail cooperative advertising industry, which is referred to sometimes as "coupons in an envelope." Valpak operates in almost all 50 states through approximately 185 U.S. franchisees, who are members of the Valpak Dealers' Association. Valpak expects to mail over 500 million pieces in 2003, and even higher volumes in succeeding years.

Valpak's business is enormously reliant on the United States Postal Service. We earnestly and enthusiastically support the Postal Service in carrying out its basic mission — to deliver the mail rapidly, reliably and economically. We need and want the Postal Service's delivery business to thrive and prosper in coming years. It is for this very reason that we have been willing to offer constructive criticism when we felt it necessary. And this is why

we are submitting suggestions to the President's Commission on the United States Postal Service.

I. Separating Root Causes from Symptoms

The Commission has doubtless heard a litany of “problems” faced by the Postal Service. Valpak urges the Commission to distinguish between alleged problems that are merely symptoms and those that constitute root causes of fundamental ills. Valpak would submit that the failure to achieve sustained productivity gains consistent with those of the private sector has been the Postal Service's most important problem by far.

A. Productivity Stagnation

Productivity has grown precious little since 1971. For over two decades, the Postal Service has suffered from a veritable drought in productivity increases. Even worse, what little trend there is shows a steady decline. True, the Postal Service occasionally has managed to achieve a significant short-term increase in Total Factor Productivity (“TFP”), such as increases of 4.0 percent and 3.8 percent in 1973 and 1993, respectively. Regrettably, however, one good year too often has been offset in subsequent years by actual declines — *i.e.*, negative productivity change.¹ The cumulative record for the entire decade

¹ See Docket No. R2001-1, testimony of Postal Service witness William P. Tayman, Jr., USPS-T-6, page 62, where he states “[t]he Postal

of the 1990's was marked by stagnation, with virtually no net gain in TFP.

This deplorable state of affairs can be observed readily from Table 1. The total gain in TFP, 11.9 percent, was equal to about one-third of broad-based private sector productivity measures over the same period.

Table 1

Increase in Postal Service Total Factor Productivity
1971-2000

Period	Percent Increase
1971-1980	6.9%
1981-1990	3.7
1991-2000	<u>1.3</u>
TOTAL	11.9%

One direct result of the failure to increase productivity has been rate cases filed more frequently and with increases much higher than otherwise should have been necessary. In an effort to divert attention from the abysmal failure to increase productivity, the rate-making mechanism unfortunately has become the subject of frequent but undeserved criticism. Like all other mailers, Valpak would like to see rate increases that are lower and inflicted less

Service's experience has been that strong productivity gains are frequently followed by losses or by very sluggish productivity growth."

frequently. We consider ourselves realists, however. The solution lies in controlling and reducing the Postal Service's costs.

Simply changing the rate-making mechanism to facilitate the ease and frequency with which rates can be raised is not, and should not be viewed as, a solution. At best, that merely would be treating the symptom, while glossing over the more fundamental problems, and if it were to reduce the Postal Service's accountability, it actually could worsen the underlying situation. Considering the complexity of rate cases, the process is remarkably efficient. The Postal Rate Commission renders a recommended decision within 10 months as the statute requires. In view of the frequent and outsized demands placed upon the existing rate-making mechanism by failure to control the Postal Service's costs, it has worked reasonably well.

One necessary improvement to the current rate-making process would be to eliminate the Governors' right to override the Postal Rate Commission, using its power to "modify," thereby making the Commission's recommendations the final decision in each case.

If both substantial and sustained improvements in Postal Service productivity can be achieved, the frequency of new rate cases can be reduced to one every four or five years. At the same time, rate increases will be smaller and more manageable. If, on the other hand, meaningful increases in productivity are not achieved, we fear that the future offers little hope for the Postal Service over a longer term, regardless of the rate-making mechanism.

Importantly, Valpak strongly believes that substantial increases in productivity are achievable. True, the Postal Service is a highly labor-intensive organization. But it does not need to be. Existing technology could be used to replace tens of thousands of workers right now.² Moreover, the technology promises to continue improving each year, enabling still further increases in productivity.

B. Recommendations to Improve Productivity

In order for the Postal Service to improve productivity, two types of actions, broadly defined, are necessary.

- Facilities that are redundant and no longer necessary must be closed and consolidated. Otherwise, the Postal Service gradually but surely will grow into an encrusted relic, akin to a modern day dinosaur (see the related discussion on retail reform, below).
- Substantial resources must be invested to modernize plant and equipment necessary for processing existing and future mail volumes efficiently (see the discussion on debt limit, below).

The lack of incentives for postal management has been cited as an explanation for the failure to modernize the postal infrastructure. The fact is, however, that closure of redundant facilities, especially post offices, has been heavily proscribed by both statutory and political considerations, and no

² Reducing the size of the labor force by improving productivity is the best way to reduce and control the problem of unfunded medical costs for retirees.

managerial incentives could reasonably be expected to overcome those legislative roadblocks. The Postal Reorganization Act of 1971 most definitely — and regrettably — did not eliminate politics from this aspect of the Postal Service. If anything, it has made the situation worse. It should be no surprise that this entire pork barrel was considered off-limits to any discussion throughout all recent Congressional attempts at so-called reform. Until this issue is addressed meaningfully, any attempt at reform will be more in name than in actual fact.

Valpak suggests that the Commission consider recommending procedures that will restrict those parochial and political considerations that have been a serious impediment to closure and consolidation of plants and post offices. Valpak concurs with recent suggestions by the U.S. General Accounting Office that Congress adopt a facility-closing mechanism similar to that used for military installations, and commends this idea to the Commission for its most serious consideration.³

³ U.S. General Accounting Office, “U.S. Postal Service: Moving Forward on Financial and Transformation Challenges,” GAO 02-694T (May 13, 2002) (“GAO Transformation Report”).

II. The Universal Service Obligation Must Be Allowed to Evolve and Adapt to a Changing Environment

The Universal Service Obligation (“USO”) has three components:

(1) make retail products reasonably available to the public; (2) deliver mail to every residence in the country; and (3) collect mail on a regular basis from collection boxes.

A. Retail reform

The Postal Service has almost 40,000 retail outlets and employs as many as 75,000 full-time equivalent workers at retail counters. According to the Postal Service’s Transformation Plan, when stamps are sold at Postal Service retail outlets it costs 24 cents to collect \$1.00 in revenue.⁴ This situation is beyond scandalous. Other than the Postal Service, no retail operation in the United States spends so much to collect one dollar of revenue.

Postal administrations of industrialized countries (*i.e.*, Europe, Australia, Canada, and New Zealand) have led the way in achieving significant reform of their retail operations, and in this regard the United States is far behind. By either franchising their retail operations extensively to the private sector, or through widespread adoption of modern technology, those other postal administrations have reduced their retail costs substantially. At the same time, convenience to the public has been increased materially (*e.g.*, postal

⁴ Transformation Plan, p. 15.

counters open in the evening, all day on Saturdays and Sundays). The Postal Service should be allowed and encouraged to do likewise. In retail alone, the Postal Service could save as much as \$2 billion annually were it not for Congressional inhibitions on change.⁵ This would give a dramatic boost to productivity.

Prior to 1971, Congress appropriated money annually to the old Post Office Department. Redundant post offices then were closed with regularity, because such closures reduced the amount that needed to be appropriated. Thus, when Congress had to pay, it gave its blessing to post office closures, despite any misgivings on the subject. Since the postal reorganization, however, Congress has loaded an unfunded mandate on the Postal Service and mailers. It has thrust the entire cost of maintaining redundant retail facilities onto ratepayers, and resisted any change in the status quo, no matter how much money could be saved. In retrospect, allowing Congress to get out of financing unnecessary post offices, while retaining the authority to mandate their continued existence, has been an unmitigated budgetary disaster for the Postal Service and mailers, who ultimately pay the entire cost.

Many communities oppose closing their local post office because it serves as a convenient meeting place. Those communities might be given the

⁵ Ironically, Congressional inflexibility with respect to closing any of the many unneeded post offices understandably seems to have inhibited opening new post offices in expanding areas where they are needed.

opportunity to take over the maintenance of their local postal facility, but the operation and financing of those redundant facilities need to be exorcized from the Postal Service's budget. The current situation is intolerable, as well as overripe for improvement, and the Commission should recommend that Congress release its iron grip on facility closings.

B. Delivery

The USO for delivery has three major components: (i) the number of delivery points served, (ii) the quality of service, and (iii) the frequency with which delivery points are served. Valpak is aware that the USO for delivery, as presently practiced, imposes a substantial fixed cost on the Postal Service and mailers.

(i) Number of delivery points served. With respect to the first component, the number of delivery points served, Valpak strongly believes that the Postal Service should continue to be charged with a mandate to deliver to every address currently served. Further, as new addresses are created, they should receive delivery service consistent with existing standards.

(ii) Quality of delivery service. Standards for mail delivery have been evolving ever since the country was founded. Rural free delivery was started experimentally only in the late 1890's, and was not made permanent and universal until the early 1900's — more than 125 years after the nation was founded. Urban mail service has never had a uniform standard. Mail can be

delivered to the door, a curbside mailbox, or a cluster box. Delivery standards must continue to evolve and adapt to changing conditions. The Postal Service has done a reasonable job of seeking the most cost-effective way to effect delivery. Those efforts need to be encouraged, not constrained. Moreover, the Postal Service also should be given the freedom to experiment and, for an appropriate fee, test offering optional, higher-quality delivery (*e.g.*, to the door).⁶

(iii) Delivery frequency. Residences in the United States now receive mail delivery six days a week, but that does not represent a universal standard. Most major office buildings in the United States are closed on Saturdays, and they receive mail only five days a week. Elsewhere, Canada, Sweden, and certain other countries deliver mail only five days a week. Valpak could manage with delivery only three days a week, provided that the mail reached every household on a reliable and consistent basis. Service standards should not be placed in a strait jacket — meaning that we should question how often we deliver to each address.

C. Mail Collection

With regard to daily pickup of mail from collection boxes, Valpak suggests that many of these collection routes, especially those in less dense areas, possibly could be subcontracted out at significant cost savings.

⁶ Telephone companies, for example, offer customers a number of options, such as caller ID, call waiting, and call forwarding.

Finally, the Commission should be acutely aware that the USO does not include activities within the upstream portion of the postal network, such as mail processing or transportation. Those activities deserve explicit exclusion not only from the USO, but also from the postal monopoly. Although downstream access to the postal network has been liberalized at least partially, the Postal Service nevertheless uses its monopoly and dominant position in the delivery market to provide billions of dollars annually to cross-subsidize its upstream services. The Postal Service should be required to compete with the private sector, and on the most level playing field that the Commission can design. That way, either the Postal Service would have to increase the productivity of its mail processing operations, or those operations would be taken over by competitors who can do the job better and cheaper.

III. Reduce the Scope of the Monopoly

Valpak recognizes that the Commission most likely will agree that the Postal Service should have imposed on it some kind of Universal Service Obligation. In order for the Postal Service to meet that USO, the Commission may consider it necessary to recommend retention of some or all of the statutory monopoly that now governs delivery of letter mail.⁷ To allow any

⁷ Valpak takes no position with respect to possible privatization of the Postal Service. At the same time, privatization and deregulation are not viewed as some magical elixir, either. Deregulation of the electricity market illustrates amply the potential pitfalls and problems that can arise from ill-

organization, government or private, to have an unfettered monopoly is not an option. Any retention of the monopoly, in turn, will necessitate some form of regulation over rates and services. No form of regulation is ideal; every regulatory model has its drawbacks. At the same time, regulation, whatever its drawbacks, has not prevented many utilities from serving the country well. It is Valpak's view that the crux of the Postal Service's problems does not lie in nuances of pricing under the Postal Reorganization Act, which has worked admirably well under the supervision of the Postal Rate Commission for over 30 years.

The Transformation Plan states that the Postal Service's desired goal is to evolve into a competitive, government-sponsored enterprise. As noted at the outset of these comments, Valpak strongly encourages the Commission to help the Postal Service become a lean, efficient delivery organization. It is not appropriate, however, for a government-sponsored monopoly to compete unfairly with private enterprise. To help the Postal Service evolve toward a competitive government enterprise in a fair manner, Valpak suggests that the Commission consider some or all of the following limitations on the Postal Service's statutory monopoly:

1. Proscribe the Postal Service from using its monopoly over delivery to subsidize upstream services such as mail processing and transportation that are provided by, and that now compete with, the private sector. In

planned deregulation.

other words, require that the rate increments charged for upstream services cover all costs of providing those services. The existing law, by requiring each subclass to bear its own attributable costs, proscribes cross-subsidization **between** subclasses. That provision of the law does not, however, prevent the Postal Service from extensively cross-subsidizing upstream activities **within** subclasses.

2. Allow the regulatory authority (currently the Postal Rate Commission) to interpret whatever monopoly the Commission should decide to recommend. Currently, the Postal Service acts as prosecutor, judge, and jury with respect to interpretation of the private express statutes.

IV. Increase the Debt Limit

When the Postal Reorganization Act became effective, it established a statutory debt limit on the Postal Service of \$10 billion. Since 1971, the statutory debt limit has been increased only once, in 1991, and then by only \$5 billion (in two equal steps); *see* Table 2, column 1.

The inflation since 1971 has seriously eroded the statutory debt limit in real economic terms. After adjusting for inflation, the statutory debt limit has declined to about one-third of the initial amount, despite the increase in 1991; *see* Table 2, column 2. At the same time, the volume of mail handled and the number of delivery points served have grown substantially over the intervening years.

Table 2

Postal Service Debt Limit
Actual and Adjusted for Inflation
 1971 – 2002
 (\$, 000)

	(1)	(2)	(3)
Year	Statutory Debt Limit	Statutory Debt Limit Adjusted for Inflation*	Original Debt Limit Adjusted for Inflation**
1971	10,000	24,691	10,000
1975	10,000	18,587	13,264
1980	10,000	12,136	20,346
1985	10,000	9,294	26,588
1990	10,000	7,651	32,272
1995	15,000	9,843	37,630
2000	15,000	8,711	42,519
2002	15,000	8,338	44,420

* CPI-U, 1982-84 = 100

** CPI-U, 1970 = 100

The financial breakeven constraint on the Postal Service puts severe limitations on any profits from which long-term capital investments can be made. Unless the Commission should decide to allow the Postal Service to earn profits and accumulate an earned surplus, it must be given the authority to borrow in order to fund the capital improvements necessary to modernize its infrastructure and effect the dramatic improvements in productivity that are

needed. At the same time, debt should not be used to underwrite operating deficits. Valpak suggests that the Commission consider a recommendation to increase the Postal Service's debt limit — **for investment purposes only** — to \$50 billion dollars. **But the Postal Service must be held accountable to require that capital investment must results in significant reduction in labor costs, and real productivity gains.** Simply to restore the debt limit, in real economic terms, to the initial level, would require \$44 billion; *see* Table 2, column 3. Increasing the debt limit to \$50 billion would allow for a small amount of future inflation, or for some of the growth in mail volume since 1971.⁸

V. Focus on Delivery of Mail

As noted above, the Postal Service needs to invest heavily in its core mission, and the future of mail. Failure to do so could make rapid diversion a self-fulfilling prediction. Valpak is strongly in favor of the Postal Service modernizing its facilities and carrying out its traditional mission to deliver the mail with ever greater efficiency, lower rates and more reliable service. Consequently, first things being first, we are strongly of the opinion that the Postal Service should invest all available resources in modernizing the postal network rather than contemplate any investment in other, non-postal ventures

⁸ Indexing the debt limit might be worth considering.

that might compete with or replace private ventures. This is especially the case so long as the Postal Service continues to be a government-owned and government-sponsored enterprise. Such ventures as the Postal Service has attempted have been almost uniformly unsuccessful, unfairly competing with private businesses, and mailers have had to bear the cost of each failure.